The Prosperity Index:
Measuring the State of the Nation's Economy

Prepared for

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http://reform.house.gov/min

October 17, 2002

Table of Contents

This report is available on the website of the minority office of The Committee on Government Reform:

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EXECUTIVE SUMMARY

During his final State of the Union address, President Bill Clinton addressed a nation that was enjoying record economic prosperity. As President Clinton recounted, the country was experiencing: "[T]he fastest economic growth in more than 30 years. The lowest unemployment rates in 30 years. . . . The first back-to-back surpluses in 42 years. And . . . the longest period of economic growth in our entire history."[1]

One year after President Clinton spoke, President George W. Bush took office. The purpose of this report is to measure what has happened to America's prosperity since the advent of the Bush Administration. The report was prepared at the request of Rep. Richard A. Gephardt, Rep. Henry A. Waxman, and Rep. John M. Spratt, Jr., by the Special Investigations Division of the minority staff of the Committee on Government Reform.

The report uses a "Prosperity Index" to assess the health of the nation's economy. This index combines three critical features of the nation's economic and fiscal well-being: the rate of growth in the gross domestic product (GDP), the unemployment rate, and the size of the budget surplus or deficit as a percentage of GDP. The Prosperity Index is constructed so that when the economy is performing well, the value of the index is positive. Correspondingly, when the economy experiences subpar performance, the value of the index is negative.

The most recent economic data indicate that the Prosperity Index has dropped precipitously since President Bush took office. The value of the Prosperity Index in 2000 was 5.9, a 34-year high. In 2001, the Prosperity Index dropped to a level of 0.4, the largest single-year decline since 1982. In 2002, to date, the Prosperity Index has fallen to a level of - 1.2, its lowest level since 1993. In a period of less than one year, the nation has gone from an economy where conditions were close to optimal to an economy where conditions are declining rapidly (Figure 1).

All three indicators that make up the Prosperity Index have dropped significantly since President Bush took office. The GDP growth rate, which was 3.8% in 2000, dropped to 1.1% in the second quarter of 2002, and is expected to be only 2.3% for the year. The unemployment rate increased from 4.2% in January 2001 to a peak of 6.0% in April 2002, averaging 5.7% for the year to date. And the budget surplus (excluding Social Security), which was $90 billion in FY2000, has evaporated. The budget is expected to record a deficit of $314 billion in fiscal year 2002, the third largest on-budget deficit in history.

The severe drop in the Prosperity Index is not the only evidence that the economy is in decline. Numerous other measures of our economic well-being also show significant drops. Since January 2001, millions of Americans have filed for bankruptcy, mortgage foreclosures have reached record highs, the economy has lost over one million jobs, and over 1.3 million Americans have slipped into poverty.

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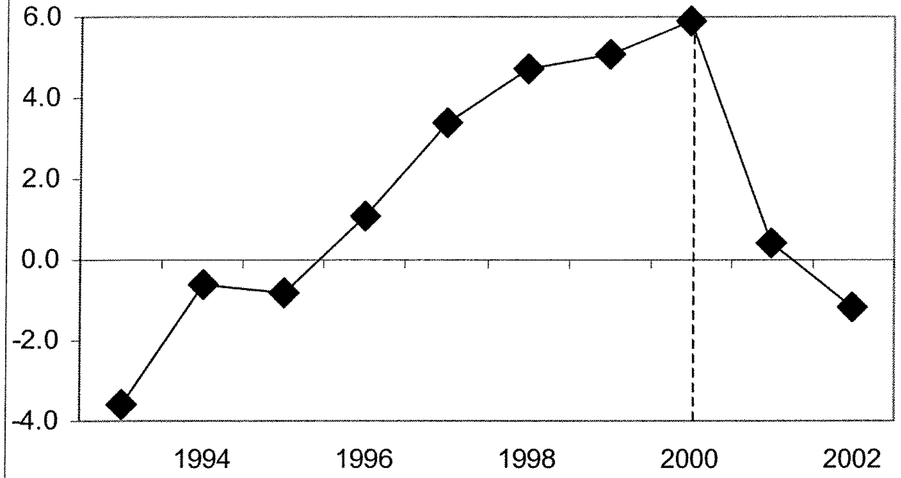
[1] *The State of the Union,* New York Times (Jan. 27, 2000).

Figure 1: After Increasing from 1993 - 2000, the Prosperity Index Has Plummeted



Economic indicators like the Prosperity Index are good measures of the performance of our economy, but they do not in themselves explain the causes of our economic conditions. Economists can debate the role of the Bush Administration's policies, such as the $1.35 trillion tax cut enacted in 2001, and other factors, such as the September 11 attacks, in causing the current economic slump. However, there can be no doubt that the prosperity that characterized the Clinton Administration has been replaced by a sudden and precipitous decline in the nation's economic well-being.

I. INTRODUCTION

In January 1993, President Bill Clinton took office with the economy still struggling in its recovery from the 1990-1991 recession. President Clinton's economic policies were embodied in his first budget, which passed by one vote in the House of Representatives with no Republican support. The budget restored fiscal discipline by cutting expenditures and raising taxes on the wealthiest 1.2% of Americans. The budget was attacked by Republican leaders. Rep. Dick Armey claimed that it was a "a cruel hoax"[2] and a "recipe for disaster,"[3] while Sen. Phil Gramm claimed that it would "make the economy weak [and cause] hundreds of thousands of people . . . to lose their jobs."[4]

Following the passage of President Clinton's first budget, the economy grew at unprecedented rates for the next eight years. As President Clinton prepared to leave office, he could legitimately claim that the country had achieved "new heights of prosperity."[5] As he noted in his January 2000 State of the Union address, the country was experiencing: "[T]he fastest economic growth in more than 30 years. The lowest unemployment rates in 30 years. The lowest poverty rates in 20 years. The lowest African-American and Hispanic unemployment rates on record. The first back-to-back surpluses in 42 years. And . . . the longest period of economic growth in our entire history."[6]

In November 2000, George W. Bush was elected President, taking office in January 2001. The signature economic policy of President Bush's first year in office was his tax cut plan. The more controversial elements of the tax cut plan were those that benefitted high income taxpayers. These included a reduction of the 36% tax bracket, extended deductions and exemptions for upper income individuals, and a repeal of the estate tax. President Bush claimed that the tax cut was "good for the economy"[7] and would "provide an important boost at an important time."[8]

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[2]Rep. Dick Armey, Congressional Record, H6267 — H6268 (Aug. 5, 1993).

[3]*Id.*

[4]*Clinton Wins Budget Vote by a Hair*, New York Times (Aug. 7, 1993) (quoting Sen. Phil Gramm).

[5]*Clinton's Address to Party: Extolling 8 Years of Change in America,* New York Times (Aug. 15, 2000).

[6]*The State of the Union,* New York Times (Jan. 27, 2000).

[7]The White House, *President Speaks at Tax Celebration Event in Iowa* (June 8, 2001).

[8]The White House, *Remarks by President Bush after Passage of the Tax Plan* (May 26, 2001).

The purpose of this analysis is to measure what has happened to America's prosperity in the two years since President Bush took office. The report has been prepared at the request of Rep. Richard A. Gephardt, Rep. Henry A. Waxman, and Rep. John M. Spratt, Jr., by the Special Investigations Division of the minority staff of the Committee on Government Reform.

II. METHODOLOGY

The report uses a "Prosperity Index" to measure our nation's economic health. The Index combines three important measures of the nation's economic well-being: the real rate of growth in the gross domestic product, the unemployment rate, and the size of the nation's budget surplus or deficit (as a percentage of total GDP).[9] After consultation with leading economists, the Prosperity Index was developed by the Special Investigations Division with the goal of providing a single indicator that can serve as a comprehensive barometer of economic conditions.

The measures in the Prosperity Index were selected because they are broad indicators of the state of the economy. The rate of GDP growth and the unemployment rate are direct measures of how fast the economy is growing and whether it is producing jobs. The budget surplus or deficit is a measure of the nation's fiscal health, representing the nation's ability to pay for necessary spending or meet future obligations.

Using these three measures, the Prosperity Index is calculated as follows:

GDP Growth Rate (%) − Unemployment Rate (%) + Budget Surplus (% of GDP) + $\mho$

In this equation, the figure $\mho$ is an adjustment factor that ensures that the Prosperity Index is equal to zero during periods of average economic conditions over a given time. From January 1960 to January 2000, the average real GDP growth rate was 3.4%; the average unemployment rate was 6.0%; and the average non-Social Security budget surplus was −2.6% of the GDP, reflecting the fact that deficits prevailed during most of this period. In this report, the figure of 5.2 is used as $\mho$ to set the average level of the Index between 1960 and 2000 at zero.

During economic periods when the economy is performing well, the Prosperity Index is positive. The Index reached its highest level since 1960, 7.6, in 1966. When economic conditions are subpar, the Prosperity Index is negative. The Index reached its lowest level since 1960, −10.2, in 1982. Between January 1960 and January 2000, the annual Prosperity Index was below zero for 18 years, equal to zero for one year, and above zero for 21 years (Figure 2).

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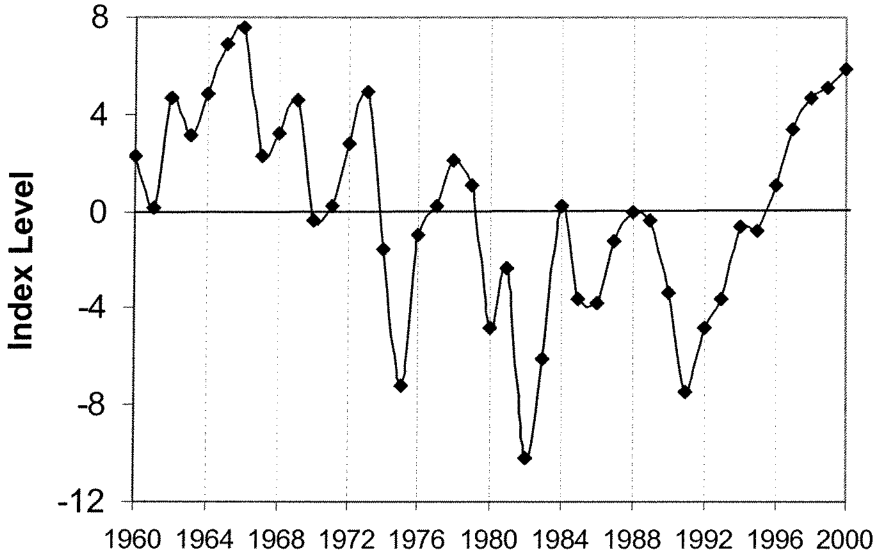
[9]The budget surplus and deficit figures used in this report are the on-budget figures, which exclude funds for Social Security and the Postal Service. The use of the on-budget surplus in the Prosperity Index provides a true indicator of the status of the government's ability to pay for present needs without dipping into Social Security funds. *See* Office of Management and Budget, *The Budget for Fiscal Year 2002: Historical Tables* (2001).

Figure 2: The Prosperity Index, 1960 - 2000



III. FINDINGS

A. The Prosperity Index Rose from 1993 to 2000

In 1992, when President Bill Clinton was elected, the nation was still suffering from the effects of the recession that peaked in 1991, and the Prosperity Index was at a level of −4.8. Over the next eight years, the Prosperity Index rose dramatically, passing into positive territory in 1996 and rising steadily thereafter. The Prosperity Index reached a peak of 5.9 in 2000, its highest level since 1966. After 1995, the Prosperity Index increased for five consecutive years, from −0.8 to 5.9. This was the longest sustained increase in the Prosperity Index since 1960.

B. The Prosperity Index Has Declined Precipitously in 2001 and 2002

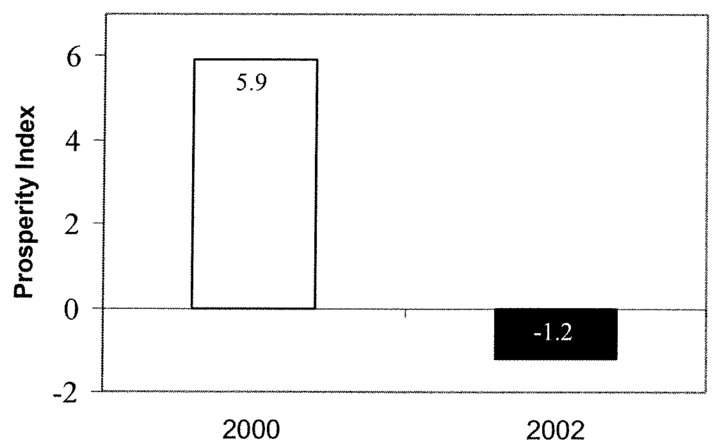
In the two years since President George W. Bush took office, the Prosperity Index has decreased precipitously. In 2001, the Prosperity Index fell from a level of 5.9 to a level of 0.4. This represented the largest single year decline since 1982. In 2002, as unemployment increased and the deficit ballooned, the Prosperity Index fell even further, to a level of −1.2.

All three indicators that make up the Prosperity Index have deteriorated sharply. The

GDP growth rate, which was at 3.8% in 2000, is expected to be only 2.3% in 2002.[10] The unemployment rate, which averaged 4.0% in 2000, has averaged 5.7% in 2002 to date.

The declining budget surplus has also dramatically impacted the Prosperity Index. In 2000, the budget surplus, excluding Social Security, was $86.6 billion. In May 2001, the Congressional Budget Office predicted that the 2001 budget surplus would be almost $100 billion and that surpluses would continue to increase. But because of President Bush's tax cut, the economic slowdown, and increased spending, the budget surplus turned into a deficit of $30 billion in 2001, and ballooned to a deficit of over $300 billion in 2002.[11]

Figure 3: The Prosperity Index Has Declined Dramatically Since President Bush Took Office



C. Other Economic Indicators Are Also Declining

The Prosperity Index is an overall measure of the nation's economic health. But there are other individual statistics that measure important aspects of the nation's economic prosperity. Most of these measures also show significant declines in 2001. For example:

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[10]Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters, Third Quarter 2002* (Aug. 22, 2002) (online at www.phil.frb.org/econ/spf/index.html). Congressional Budget Office, *Current Economic Projections* (August 2002).

[11]Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2002).

- In 2000, the year before President Bush took office, the economy created 1.7 million new jobs. That trend has been reversed, and since January 2001 the economy has lost almost 1.5 million jobs.[12]

- Hundreds of thousands of Americans are filing for bankruptcy. Almost 800,000 Americans filed for bankruptcy in the first half of 2002. In the second quarter of 2002, over 400,000 bankruptcies were filed in the United States, an all-time high.[13]

- Mortgage foreclosures reached record highs. In the second quarter of 2002, 1.23% of home loans were in the foreclosure process, a record level. Over this same time period, almost 5% of mortgage loans were delinquent, up almost 20% from the average delinquency rate in 2000.[14]

- After decreasing for eight straight years and reaching its lowest level in 25 years, the poverty rate increased from 11.3% in 2000 to 11.7% in 2001. In the first year of the Bush Administration, 1.3 million Americans slipped back into poverty.[15]

D. Interpretation of Results

Economic indicators like the Prosperity Index are good measures of the performance of our economy, but they do not in themselves explain the causes of our economic conditions. A number of factors, some within the control of the President and some not, have affected the economy since President Bush took office.

One major development affecting the nation's prosperity is the $1.35 trillion tax cut proposed by President Bush and passed by Congress in 2001. The tax cut in particular has a significant impact on one component of the Prosperity Index, the size of the budget deficit. Over the next ten years, the tax cut will be the single largest contributor to the reduction in federal revenues. The White House Office of Management and Budget estimates that the tax cut will

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[12]Bureau of Labor Statistics, *Employment Situation Summary* (September 2002) (online at www.bls.gov).

[13]American Bankruptcy Institute, *Bankruptcy Cases Total More Than 1.5 Million for First Time, Personal and Quarterly Filings Hit Historic Highs* (Aug. 14, 2002) (online at http://www.abiworld.org/release/2Q2002.html).

[14]Mortgage Bankers Association of America, *Delinquencies and Foreclosures Increase Slightly in Second Quarter 2002* (Sept. 9, 2002) (online at www.mbaa.org).

[15]U.S. Census Bureau, *Money Income in the United States: 2001* (September 2002).

account for approximately 40% of the total decline in the ten-year surplus.[16] OMB also estimates that $65 billion of this year's $314 billion dollar deficit is attributable to the tax cut.[17]

Economists and policy experts continue to debate the impact of the tax cut on GDP and unemployment. President Bush and his administration argue that the tax cut has been healthy for the economy, increasing the economic growth rates and reducing unemployment.[18] But other economists have argued that because of the substantial impact that the tax cut has on the federal budget deficit and long-term interest and savings rates, it has a net negative effect on the economy.[19]

In addition to the 2001 tax cuts, other events also impacted the economy, such as the recession and the September 11 terrorist attacks. The September 11 attacks had a measurable impact on the economy in the short run, and they were a major shock for certain sectors, such as the hospitality and travel industries. However, they are not expected to have a significant long-term effect on the economy as a whole and were not the cause of the recession. Economists at the respected UCLA Anderson School of Business have concluded: "The recession was clearly underway prior to 9/11, and there is no reason in economic science to give the terrorists that much credit."[20]

Economists can debate the role of the Bush Administration's policies and other factors, such as the September 11 attacks, in causing the current economic slump. However, there can be no doubt that the prosperity that characterized the Clinton Administration has been replaced by a sudden and precipitous decline in the nation's economic well-being.

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[16] *See* Office of Management and Budget, *Mid Session Review* (August 2002) (online at http://www.whitehouse.gov/omb/budget/fy2003/msr02.html). Based on legislation passed by Congress to date, OMB estimated that the surplus had declined by almost four trillion dollars. OMB also estimated that President Bush's tax cut cost $1.5 trillion, accounting for 38% of the decline.

[17] *Id. See* Chart 1.

[18] *Id.*

[19] *See, e.g.,* William Gale and Samantha Potter, The Brookings Institution, *The Bush Tax Cut: One Year Later* (June 2002).

[20] UCLA Anderson School of Business, *Anderson Business Forecast: Not Long, Not Deep, But Not Much of a Recovery Either* (Dec. 5, 2001).

IV. CONCLUSION

The Prosperity Index is an indicator of the state of the nation's economy. Under President Clinton, the Prosperity Index rose dramatically, reaching a peak of 5.9 in 2000. In the two years since President Bush took office, the Prosperity Index has reversed course, undergoing the largest decline in 20 years and falling to a level of − 1.2.